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Securities Law — Rule 10b-5— Purchaser-Seller Requirement — Blue Chip Stamps v Manor Drug Stores

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NOTES

Securities Law—Rule 10b-5—Purchaser-Seller Requirement—*Blue Chip Stamps v. Manor Drug Stores*[1]—Blue Chip Stamp Company (Old Blue Chip) was in the business of providing trading stamps to retailers.[2] In 1963, the United States commenced a civil antitrust action[3] against Old Blue Chip and nine retailers who owned 90 percent of its shares.[4] This action was terminated in 1967 by the entry of a consent decree under which Old Blue Chip was to be merged into a newly formed company (New Blue Chip).[5] The holdings of the majority shareholders of Old Blue Chip were to be reduced by requiring New Blue Chip to offer a substantial number of its shares to retailers who had used the stamp service in the past, but who previously had not been shareholders.[6] The shares were offered in units consisting of three shares of common stock and a $100 debenture for a total price of $101.[7] The number of shares offered to each retailer was proportional to its past stamp usage.[8] As required by section 5 of the Securities Act of 1933 (the 1933 Act),[9] New Blue Chip tendered the shares to each offeree by means of a prospectus.[10] Over 50 percent of the units offered to the nonshareholder retailers were actually purchased.[11]

Two years after this offer, Manor Drug Stores, a former user of the stamp service and one of the offerees who had not purchased any of the units, brought a class action against Old Blue Chip, eight of its nine majority shareholders, and New Blue Chip and its directors.[12] The complaint alleged violations of section 12 of the 1933 Act,[13] section 10(b) of the Securities Exchange Act of 1934 (the 1934 Act),[14]

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[1] 421 U.S. 723 (1975).

[2] *Id.* at 725.

[3] United States v. Blue Chip Stamp Co., 272 F. Supp. 432 (C.D. Cal. 1967), *aff'd per curiam sub nom.* Thrifty Shoppers Scrip Co. v. United States, 389 U.S. 580 (1968).

[4] 421 U.S. at 725.

[5] *Id.* at 725-26.

[6] *Id.* at 726.

[7] *Id.* at 763 (Blackmun, J., dissenting).

[8] 421 U.S. at 726.

[9] 15 U.S.C. § 77e (1970).

[10] 421 U.S. at 726.

[11] *Id.*

[12] *Id.*

[13] 15 U.S.C. § 77*l* (1970).

[14] 15 U.S.C. § 78j(b) (1970) which provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
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> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may pre-

and Rule 10b-5.[15] Plaintiff asserted that New Blue Chip's prospectus was materially misleading in that it was overly pessimistic in its appraisal of New Blue Chip's current status and future prospects.[16] It was alleged that these pessimistic statements were made for the purpose of discouraging the plaintiff and other members of its class from accepting the offer, which had been priced below market value,[17] so that the rejected units could then be offered to the public at a higher price.[18] Plaintiff sought actual damages of $21,400,000,[19] the right to purchase the previously rejected shares at the original offering price,[20] and exemplary damages of $25,000,000.[21]

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scribe as necessary or appropriate in the public interest or for the protection of investors.

[15] 17 C.F.R. § 240.10b-5 (1975), which provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,
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> (a) to employ any device, scheme, or artifice to defraud,
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> (b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or,
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> (c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security.

[16] 421 U.S. at 726.

The prospectus contained the following statements, allegedly false and allegedly made to deter the plaintiff and its class from purchasing the units: (1) that "[n]et income for the current fiscal year will be adversely affected by payments aggregating $8,486,000 made since March 2, 1968, in settlement of claims" against New Blue Chip; (2) that net income "would be adversely affected by a substantial decrease in the use of the Company's trading stamp service"; (3) that net income "would be adversely affected by a sale of one-third of the Company's trading stamp business in California"; (4) that "Claims or Causes of Action (as defined) against the Company, including prayers for treble damages, now aggregate approximately $29,000,000"; and (5) that, based upon "statistical evaluations," "the Company presently estimates that 97.5% of all stamps issued will ultimately be redeemed."

Id. at 763-64 (Blackmun, J., dissenting).

[17] 421 U.S. at 726-27. Plaintiff claimed that the reasonable market value of each unit when offered was $315. *Id.* at 763 (Blackmun, J., dissenting).

[18] 421 U.S. at 727.

[19] *Id.* This figure was obtained by multiplying the difference between the market value and the offer price by the number of units that had not been purchased. Thus, ($315-$101) X 100,000 = $21,400,000. Appendix at 12, Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975).

[20] *Id.* As this would amount to double recovery, it may have been requested as an alternative remedy.

[21] *Id.* The exemplary damages were apparently sought under a state claim that was joined with federal claims under pendent jurisdiction. *See* Manor Drug Stores v. Blue Chip Stamps, 339 F. Supp. 35, 37 (C.D. Cal 1971), *rev'd*, 492 F.2d 136 (9th Cir. 1973), *rev'd*, 421 U.S. 723 (1975). Normally, exemplary damages are not recoverable under federal securities laws, unless there is a state claim joined under pendent jurisdiction. *See* Coffee v. Permian Corp., 474 F.2d 1040, 1044 (5th Cir.), *cert. denied*, 412 U.S. 920 (1973); 15 U.S.C. § 78bb(a) (1970) (recovery under the 1934 Act limited to actual damages).

The district court dismissed the complaint on all counts,[22] reasoning, first, that the plaintiff was not a party to the antitrust consent decree and therefore could not enforce it,[23] and second, that section 12 of the 1933 Act expressly required that a plaintiff be a purchaser.[24] Since plaintiff had never purchased any units, he could not maintain an action under this section.[25] Finally, the district court reasoned that the *Birnbaum* doctrine[26] required the plaintiff in an action for damages under section 10(b) and Rule 10b-5 to be a purchaser or seller of securities.[27] Again, plaintiff's failure to purchase the offered units precluded it from obtaining relief.[28]

On appeal, plaintiff pressed only its claim under Rule 10b-5. The United States Court of Appeals for the Ninth Circuit reversed, in a split decision.[29] The majority reasoned that under the general rule, only purchasers and sellers could sue for damages under section 10(b) and Rule 10b-5.[30] However, there were exceptions to this rule, especially where objective evidence of the plaintiff's intent to purchase or sell but for the alleged fraud was offered.[31] In many of the cases finding exceptions, there had been a contract to purchase or sell, which furnished objective evidence of the potential transaction.[32] These contracts also fixed the price, quantity, and time of the transaction, thereby making it possible to calculate damages.[33] The majority reasoned that the antitrust decree in the present case served the same function as a contract;[34] to insist on an actual contract would subordinate substance to form.[35]

The dissent did not agree that the consent decree served the same functions as a contract, because, unlike a contract, a consent decree is not the statutory equivalent of a purchase or sale.[36] Furthermore, the consent decree did not create any legal rights or duties in the plaintiff.[37] Thus, the plaintiff was in the same position as any other disappointed public offeree.[38] In addition, the dissent reasoned

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[22] Manor Drug Stores v. Blue Chip Stamps, 339 F. Supp. 35, 40 (C.D. Cal. 1971).

[23] *Id.* at 38.

[24] *Id.* at 38-39.

[25] *Id.*

[26] *See* Birnbaum v. Newport Steel Corp., 193 F.2d 461, 464 (2d Cir.), *cert. denied,* 343 U.S. 956 (1952).

[27] 339 F. Supp. at 39-40.

[28] *Id.*

[29] Manor Drug Stores v. Blue Chip Stamps, 492 F.2d 136 (9th Cir. 1973).

[30] *Id.* at 140-41.

[31] *Id.* at 141-42.

[32] *Id.*

[33] *Id.* at 142.

[34] *Id.*

[35] *Id.*

[36] *Id.* at 143-44 (dissenting opinion). In the 1934 Act, the term "purchase" is defined to include contracts to purchase or acquire securities. 15 U.S.C. § 78c(a)(13) (1970).

[37] 492 F.2d at 144 (dissenting opinion).

[38] *Id.* at 146.

that the disadvantages of expanding the class of potential plaintiffs to include those who are neither purchasers nor sellers would outweigh the benefits, since the effect of such an expansion might so far unsettle the securities market as to defeat, rather than promote, the protective purposes of Congress in enacting the statute.[39]

The Supreme Court, in a 6-3 decision, reversed the court of appeals and HELD: Only an actual purchaser or seller of securities may maintain a private action for damages under section 10(b) and Rule 10b-5.[40] As plaintiff had neither purchased nor sold any of the offered units in Blue Chip Stamps, its action was dismissed.[41]

Since the purchaser-seller requirement was first enunciated in *Birnbaum v. Newport Steel Corp.*,[42] there has been much debate as to whether private actions under Rule 10b-5 should be so limited. While most courts have at least voiced approval of the *Birnbaum* doctrine,[43] they have applied this rule expansively and flexibly, defining "purchaser" and "seller" beyond their common law meaning.[44] Only the Seventh Circuit in *Eason v. G.M.A.C.*[45] had expressly abolished the purchaser-seller rule.[46] However, the doctrine has been criticized by many writers as being unduly arbitrary and restrictive.[47] By approving the purchaser-seller requirement, the Supreme Court has resolved, at least for the time being, one controversial aspect of private litigation under section 10(b) and Rule 10b-5.

This note will begin by tracing the origin and development of the purchaser-seller requirement. The reasoning of the Supreme Court in *Blue Chip Stamps* will then be analyzed. Specifically, the legislative history and policy considerations relating to section 10(b) and Rule 10b-5, which were so much relied upon by the Court, will be examined to determine whether they truly support the Court's conclusion. Other factors that the court did not mention—such as several of the reasons for allowing private litigation under § 10(b)—will also be discussed. Finally, an alternative to the *Birnbaum* purchaser-seller requirement will be explored. It will be submitted that the *Birnbaum* doctrine is unduly restrictive of section 10(b) protection and should therefore be abolished by Congress.

I. ORIGIN AND DEVELOPMENT OF THE PURCHASER-SELLER RULE

In the early 1930's Congress enacted two major statutes regulat-

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[39] *Id.* at 147-48.

[40] 421 U.S. at 731, 750-51.

[41] *Id.* at 754-55.

[42] 193 F.2d 461, 464 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952).

[43] *Blue Chip Stamps*, 421 U.S. at 733.

[44] Herpich v. Wallace, 430 F.2d 792, 806 (5th Cir. 1970). For example, a beneficiary of a trust may sue under Rule 10b-5 where the securities have been fraudulently purchased or sold. James v. Gerber Prods. Co., 483 F.2d 944 (6th Cir. 1973).

[45] 490 F.2d 654 (7th Cir. 1973), *cert. denied*, 416 U.S. 960 (1974).

[46] *Id.* at 661.

[47] *E.g.*, Lowenfels, *The Demise of the Birnbaum Doctrine: A New Era for Rule 10b-5*, 54 VA. L. REV. 268, 275-76 (1968).

ing the securities area: the Securities Act of 1933 and the Securities Exchange Act of 1934. The Securities Act of 1933 was concerned primarily with the original issuance of securities, whereas the 1934 Act dealt mainly with the trading of securities in the open markets and exchanges.[48] The 1934 Act was enacted to prohibit manipulative devices[49] and to require full and accurate disclosure.[50] Section 10(b) was specifically enacted to accomplish these purposes[51] by authorizing the SEC to promulgate appropriate rules and regulations. In response, the SEC in 1942 promulgated Rule 10b-5,[52] which was copied almost verbatim from section 17(a) of the 1933 Act.[53] However, neither section 10(b) nor Rule 10b-5 expressly provide for private remedies, and there is no indication that this relief was ever considered.[54]

This gap was filled in 1946, when the district court in *Kardon v. National Gypsum Co.*[55] held that a private remedy exists for violations of Rule 10b-5.[56] This holding was finally approved twenty-five years later by the Supreme Court in *Superintendent of Insurance v. Bankers Life & Casualty Co.*[57] The purchaser-seller requirement followed closely on the heels of the *Kardon* decision. The rule was first enunciated in 1952 by the Second Circuit in *Birnbaum v. Newport Steel Corp.*[58] In *Birnbaum*, plaintiff stockholders of the Newport Steel Corporation alleged violations of Rule 10b-5 by Feldmann, the president and chairman of Newport's board of directors and owner of 40 percent of Newport's common stock.[59] Newport and Follansbee Steel Corporation, another steel company, had been negotiating a merger that would have been highly favorable to all Newport shareholders. Acting in his capacity as president, Feldmann rejected this offer. However,

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[48] S. REP. NO. 792, 73d Cong., 2d Sess. 3 (1934).

[49] *Id.* at 7.

[50] *Id.* at 10-11.

[51] Section 10(b)'s scope is very broad. One of the drafters of the 1934 Act noted, "[Section 10(b)] says, 'Thou shalt not devise any other cunning devices.' " *Hearing on H.R. 7852 and H.R. 8720 Before the Comm. on Interstate and Foreign Commerce*, 73d Cong., 2d Sess. 115 (1934). He also noted that this provision was a "catch all to prevent manipulative devices .... The Commission should have the authority to deal with new manipulative devices." *Id.*

[52] *See* SEC Security Exchange Act Release No. 3230 (May 12, 1942).

[53] For an account of how Rule 10b-5 was drafted, *see* Remarks of Milton Freeman, *Conference on Codification of the Federal Securities Laws*, 22 BUS. LAW. 793, 922 (1967).

[54] *Blue Chip Stamps*, 421 U.S. at 729-30.

[55] 69 F. Supp. 512 (E.D. Pa. 1946).

[56] *Id.* at 513-14. Apparently, the *Kardon* court did not limit the plaintiff class to purchasers and sellers. *See id.* at 514.

[57] 404 U.S. 6, 13 n.9 (1971).

[58] 193 F. 2d 461, 464 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952). The distinguished panel which decided this case was comprised of Judges Learned Hand, Thomas Swan, and Augustus Hand, who wrote the opinion. At least one case decided before *Birnbaum* allowed a nonpurchaser or nonseller to sue under Rule 10b-5. *See* McManus v. Jessup & Moore Paper Co., Civ. No. 8015 (E.D. Pa. 1948), *cited in* 59 YALE L.J. 1120, 1137 n.87 (1950).

[59] 193 F.2d at 462.

he later sold his own stock to the Wilport Company at twice the stock's market value. Plaintiffs alleged that Feldmann and others made misrepresentations to them, both before and after his transactions, in connection with the sale of his stock in violation of Rule 10b-5.[60]

The district court dismissed the complaint for failure to state a cause of action,[61] and the court of appeals affirmed.[62] The court of appeals noted that prior to the adoption of Rule 10b-5, there had been only two sections in the 1933 and 1934 Acts dealing with fraudulent practices: section 17(a) of the 1933 Act[63] (applicable only to fraud committed upon purchasers of securities) and section 15(c) of the 1934 Act[64] (applicable only to fraud committed upon sellers by brokers or dealers).[65] The Securities Acts did not prohibit fraud by a purchaser of securities who was not a broker or dealer. The court reasoned that the SEC's purpose in promulgating Rule 10b-5 was to close this existing loophole in the securities laws so as to prohibit fraud committed by purchasers of securities.[66] Emphasizing that Rule 10b-5 was copied almost verbatim from section 17(a), the court concluded that the only purpose of this rule was to make the prohibitions of section 17(a) applicable to purchasers as well as sellers.[67] Thus, it was held that section 10(b) "was directed solely at that type of misrepresentation or fraudulent practice usually associated with the sale or purchase of securities rather than at fraudulent mismanagement of corporate affairs, and that Rule [10b-5] extended protection only to the defrauded purchaser or seller."[68]

Although the court in *Birnbaum* relied on the SEC's apparent in-

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[60] *Id.*

[61] Birnbaum v. Newport Steel Corp., 98 F. Supp. 506, 509 (S.D.N.Y. 1951) (Kaufman, J.).

[62] 193 F.2d at 462-63, 464.

[63] 15 U.S.C. § 77q(a) (1970).

[64] 15 U.S.C. § 78o(c) (1970).

[65] 193 F.2d at 463.

[66] *Id.*, *citing* SEC Security Exchange Act Release No. 3230 (May 21, 1942), which provides in part:

> The Securities and Exchange Commission today announced the adoption of a rule prohibiting fraud by any person in connection with the purchase of securities. The previously existing rules against fraud in the purchase of securities applied only to brokers and dealers. The new rule closes a loophole in the protections against fraud administered by the Commission by prohibiting individuals or companies from buying securities if they engage in fraud in their purchase.

[67] 193 F.2d at 463.

[68] *Id.* at 464. The *Birnbaum* doctrine actually consisted of two parts. Whitaker, *The Birnbaum Doctrine: An Assessment*, 23 ALA. L. REV. 542, 547 (1971). The first part limited the scope of section 10(b) to the prohibition of fraud usually associated with the purchase or sale of securities. This limitation was abolished in Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 10-13 (1971). *See* Jannes v. Microwave Communications, Inc., 461 F.2d 525, 528-30 (7th Cir. 1972). The second part of the *Birnbaum* doctrine is the purchaser-seller requirement, and is thus the only part with which *Blue Chip Stamps* was concerned.

tent in promulgating Rule 10b-5,[69] the SEC has since become disenchanted with the purchaser-seller requirement. In 1957 and again in 1959, the SEC urged Congress to amend section 10(b) to change its wording from "in connection with the purchase or sale of any security" to "in connection with the purchase or sale of, or any attempt to purchase or sell, any security."[70] The purpose of the proposed amendments was threefold. First, the amendments were designed to reach the "so-called front money racket."[71] Second, the amendments would have extended generally the reach of section 10(b) to include fraud "in connection with attempts to buy or sell stocks as well as in connection with consummated transactions."[72] Finally, the amendments would have made unnecessary any proof of the elements of conspiracy, "often difficult to make out."[73] Congress failed to enact these amendments each time they were proposed.[74] Since then, the SEC has submitted amicus curiae briefs in several cases urging judicial elimination of the *Birnbaum* doctrine.[75] Despite the controversy surrounding the purchaser-seller requirement, the Supreme Court had never ruled on its validity prior to the decision in *Blue Chip Stamps*.

II. *BLUE CHIP STAMPS*: A BLUE CHIP OFF THE OLD *BIRNBAUM*

In *Blue Chip Stamps*, the Supreme Court adopted the *Birnbaum* rule and held that only an actual purchaser or seller may sue for violation of Rule 10b-5.[76] First, on the basis of history, the Court concluded that Congress' failure to reject *Birnbaum* despite opportunity to do so and the lower courts' longstanding acceptance of the doctrine were significant factors arguing for final acceptance of the purchaser-seller requirement.[77]

Second, the available extrinsic evidence, though not conclusive, also supported the *Birnbaum* rule.[78] As the Court noted, the "purchase or sale" language of section 10(b) stands in contrast with that of other provisions of the securities laws. Section 17(a) of the 1933 Act,[79] for example, from which Rule 10b-5 was drawn, prohibits fraud "in the

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[69] See text at note 67 *supra*.

[70] S. 2545, 85th Cong., 1st Sess., *cited in* 103 CONG. REC. 11636 (1957); SEC Legislation, *Hearings on S. 1179 Before a Subcomm. of the Comm. on Banking & Currency*, 86th Cong., 1st Sess. 294 (1959).

[71] *Id.* at 367. Under this scheme, a promoter will obtain money from a company based on his fraudulent promise to distribute securities for the issuer. *Id.* at 367-68.

[72] *Id.* at 368. The securities industry feared that this amendment would make it difficult to predict how far civil liability would be extended. *Id.*

[73] *Id.*

[74] *Blue Chip Stamps*, 421 U.S. at 732.

[75] *E.g.*, Brief for SEC as Amicus Curiae, Vine v. Beneficial Fin. Co., 374 F.2d 627 (2d Cir.), *cert. denied*, 389 U.S. 970 (1967).

[76] 421 U.S. at 755.

[77] *Id.* at 733.

[78] *Id.* at 733-36.

[79] 15 U.S.C. § 77q(a) (1970).

offer or sale" of securities.[80] Furthermore, as section 16(b) of the 1934 Act[81] demonstrates, where Congress wished to expressly provide a remedy to those who neither purchased nor sold securities, it had little difficulty in doing so.[82] Section 28(a) of the 1934 Act,[83] which limits recovery in any private damage action to "actual damages," also lends support to the purchaser-seller requirement.[84] A nonpurchaser or nonseller could sue only for an "intangible economic injury," since the determination of the number of shares he might have bought or sold would depend on his "subjective hypothesis."[85] Only an actual purchaser or seller could base his recovery on a "demonstrable number of shares traded," thus fulfilling the actual damages requirement of section 28(a).[86]

Support for the *Birnbaum* rule was also found in section 29(b) of the 1934 Act.[87] Section 29(b), which underlies the implied private cause of action under section 10(b),[88] provides that a contract made in violation of any provision of the 1934 Act is voidable at the option of the deceived party.[89] This contract and, therefore, the implied private cause of action, cannot exist where there has not been a purchase or sale of securities.[90] Moreover, those sections of the 1933 and 1934 Acts which do expressly provide for private civil remedies—sections 11(a)[91] and 12[92] of the 1933 Act, and sections 9(e)[93] and 18[94] of the 1934 Act—limit standing to purchasers and sellers.[95] The court felt it would be anomalous to impute to Congress an intention to expand the plaintiff class for a judicially implied cause of action beyond the limits set forth by Congress for a comparable express cause of action.[96]

Finally, policy considerations relating to the purchaser-seller requirement were discussed. The majority agreed that the *Birnbaum* doctrine was an arbitrary restriction preventing some deserving plaintiffs from recovering damages which were in fact caused by violations of Rule 10b-5.[97] Absent countervailing advantages, this fact alone

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[80] *Id.* (emphasis added). *See also* 15 U.S.C. §§ 77e, 77*l* (1970) (both sections dealing with offers).

[81] 15 U.S.C. § 78p(b) (1970) (issuer may recover insider's profits from short swing transaction).

[82] *Blue Chip Stamps*, 421 U.S. at 734.

[83] 15 U.S.C. § 78bb(a) (1970).

[84] *Blue Chip Stamps*, 421 U.S. at 734-35.

[85] *Id.*

[86] *Id.* at 734.

[87] 15 U.S.C. § 78cc(b) (1970).

[88] Kardon v. National Gypsum Co., 69 F. Supp. 512, 514 (E.D. Pa. 1946).

[89] *Id.*

[90] 421 U.S. at 735.

[91] 15 U.S.C. § 77k (1970).

[92] *Id.* § 77*l*.

[93] *Id.* § 78i(e).

[94] *Id.* § 78n.

[95] 421 U.S. at 735-36.

[96] *Id.* at 736.

[97] *Id.* at 738.

would have rendered the *Birnbaum* rule undesirable as a matter of policy, regardless of its support by precedent and legislative history.[98] However, other policy considerations, more important in the Court's opinion, weighed in favor of maintaining the doctrine.[99]

The Court stated that litigation under rule 10b-5 presented a danger of vexatious abuse different in degree and in kind from that inherent in other litigation.[100] There was concern that in the field of federal securities laws governing the disclosure of information, even a tenuous claim has an inflated settlement value far in excess of its chances for success on the merits. This is true as long as the plaintiff can avoid dismissal before trial.[101] One reason given by the Court for this inflated settlement value is that the pendency of the lawsuit may interfere with the defendant's normal business activity even though totally unrelated to the suit.[102] Another reason is the possibility that a plaintiff might abuse the discovery process.[103] Thus, many corporations find it in their financial interest to settle, albeit at an inflated value, rather than proceed to trial.[104]

The Court's major concern, however, was that absent the *Birnbaum* doctrine, and assuming no settlement, "the trier of fact [would then be faced with] many rather hazy issues . . . proof of which [would depend] almost entirely on oral testimony."[105] The danger of abuse of oral testimony appeared to the Court to exist to a particularly high degree in this type of action.[106] Plaintiff's proof that he failed to purchase or sell by reason of defendant's violation of Rule 10b-5 could not be verified by documentation, but would depend to a large extent on his uncorroborated oral testimony that he had been influenced by the alleged misrepresentations.[107] Much of this testimony would concern matters exclusively within the plaintiff's own knowledge, and thus could not be directly refuted by the defendant.[108] This peculiarity of proof, which works to the plaintiff's advantage, would, the Court concluded, encourage plaintiffs to maintain vexatious suits based on dubious claims.[109]

The *Birnbaum* doctrine was seen by the Court as mitigating this problem of "blackmail suits" brought to force the inflated settlement of a tenuous claim. Without the *Birnbaum* rule, an action under Rule 10b-5 would always turn on which party's oral testimony the jury

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[98] *Id.* at 738-39.
[99] *Id.* at 739.
[100] *Id.*
[101] *Id.* at 740-43.
[102] *Id.* at 740-41.
[103] *Id.* at 741.
[104] *Id.* at 740-43.
[105] *Id.* at 743.
[106] *Id.*
[107] *Id.* at 746.
[108] *Id.*
[109] *Id.* at 746-47.

would decide to credit.[110] There would be virtually no way to dispose of the suit before a trial other than by settlement, no matter how improbable the plaintiff's allegations.[111] The *Birnbaum* doctrine was seen to alleviate this problem by providing a basis for the pre-trial, mechanical exclusion of nonpurchasers and nonsellers. Since the fact of a purchase or sale is generally verifiable by documentation, failure to qualify under *Birnbaum* may usually be established on a motion to dismiss.[112] The rule was thus deemed to separate the group of plaintiffs who actually bought and sold securities, and whose version of the facts was felt generally more likely to be believed by the trier of fact, from the many plaintiffs who could get to trial in the absence of the rule but who presumably would have little chance of success in proving their claim.[113] Indeed, without the purchaser-seller requirement, a mere bystander could await a change in the market for a security without risk of loss and then file a suit claiming that he had been left on the sidelines due to fraud.[114] The Court thus concluded that the *Birnbaum* doctrine excludes those plaintiffs most likely to maintain vexatious suits,[115] and therefore should be followed.[116]

In closing, the Court criticized the court of appeals' approach to the case. The court below had concluded that plaintiff's status as an offeree pursuant to the terms of the consent decree served the same function of limiting the class of plaintiffs as was normally performed by the requirement of a contractual, purchaser-seller relationship.[117] The Supreme Court stated, however, that persons with contracts to purchase and sell are considered to be purchasers and sellers, not because of a judicial conclusion that they are similarly situated to purchasers and sellers, but rather because the definitional provisions of the 1934 Act give them such a status.[118] Since these definitional provisions make no reference to offerees, such persons are not considered to be purchasers or sellers entitled to sue.[119]

The Court further noted that although prominent emphasis must be given in a prospectus to material adverse contingencies, there was evidence that Congress did not intend to create a private action for the loss of an opportunity to partake of a stock offering made

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[110] *Id.* at 742.

[111] *Id.*

[112] *Id.*

[113] *Id.* at 743.

[114] *Id.* at 747.

[115] *See id.* The dissent criticized this argument on the basis that it is speculative and conjectural. The dissent also noted that it was unwarranted for the Court to take judicial notice of the reasons for settling a case or of the difficulties of proof. *Id.* at 769-70 (Blackmun, J., dissenting).

[116] 421 U.S. at 749.

[117] *Id.* at 749-50.

[118] *Id.* at 750-51, *citing* 15 U.S.C. §§ 78c(a)(13), (14) (1970) which provides "(13) The terms 'buy' and 'purchase' each include any contracts to buy, purchase, or otherwise acquire. (14) The terms 'sale' and 'sell' each include any *contract* to sell or otherwise dispose of." (emphasis supplied).

[119] 421 U.S. at 751.

pursuant to the 1933 Act due to "an overly pessimistic prospectus."[120] Moreover, the court refused to imply such an action, despite a greater likelihood of influence in this case—where plaintiff's managers had read the trusted defendant's alleged misrepresentations—than there would be in a case filed by a complete stranger to the corporation.[121] Opening up the *Birnbaum* doctrine to such a case by case erosion would result in a "shifting and highly fact-oriented disposition"[122] of the standing issue, which would not be "a satisfactory basis for a rule of liability imposed on the conduct of business transactions."[123] As plaintiff was neither a purchaser nor a seller it lacked standing to bring a private action under Rule 10b-5.[124]

In *Blue Chip Stamps,* the Supreme Court relied heavily on the legislative and judicial history of the 1933 and 1934 Acts and on the policy considerations underlying section 10(b) and Rule 10b-5. It is submitted, however, that these factors do not mandate the majority's decision. Furthermore, an examination of the *Birnbaum* doctrine in light of other considerations which the Court did not discuss leads to the conclusion that the better decision would have been to overrule *Birnbaum.*

The majority concluded that the lower courts' longstanding acceptance of *Birnbaum* and Congress' failure to amend section 10(b) and reject the purchaser-seller requirement were significant factors arguing for its acceptance.[125] It is unlikely that such deference to judicial and legislative inertia was warranted. The *Birnbaum* court's rationale in adopting the purchaser-seller requirement was based almost exclusively on the SEC's stated purpose in promulgating Rule 10b-5.[126] However, at the time these statements were made the SEC's limited goal was to extend the antifraud remedies protecting purchasers under section 17(a) of the 1933 Act to include the protection of sellers;[127] the SEC has since argued that Rule 10b-5 should be given a broader interpretation.[128] Thus, the *Birnbaum* doctrine remains static while its very underpinning has gradually changed. Furthermore, the plaintiffs in *Birnbaum* were not connected with any actual *or potential* transaction. They were never in the position of becoming purchasers or sellers; there could not be any "connection" between the alleged fraud and a purchase or sale by the plaintiffs. Thus, the plaintiffs in *Birnbaum* were correctly denied standing, since the alleged action was

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[120] *Id.* at 752-54.
[121] *Id.* at 754-55.
[122] *Id.* at 755.
[123] *Id.*
[124] *Id.* at 754-55.
[125] *Id.* at 733.
[126] 193 F.2d at 463-64; Comment, 6 LOYOLA U. CHI. L.J. 230, 235 (1975). It has been suggested that this rationale is not convincing. Boone & McGowan, *Standing to Sue Under SEC Rule 10b-5,* 49 TEX. L. REV. 617, 621 (1971).
[127] SEC Security Exchange Act Release No. 3230 (May 12, 1942).
[128] See text at notes 70-75 *supra.*

not within the scope of section 10(b) and Rule 10b-5.[129] But the fact that the *Birnbaum* plaintiffs were correctly denied standing does not adequately serve as the basis for a broad rule that *all* nonpurchasers and nonsellers be denied relief.[130]

Congress' failure to amend section 10(b) in 1957 and 1959 does not compel the conclusion that the *Birnbaum* doctrine was thereby accepted. First, in each year, the proposed amendment of section 10(b) was only one item in several bills that would have modified many other sections of the securities laws.[131] It appears that none of these bills were ever enacted. Second, there were three reasons given for the proposed amendment of section 10(b), only the second of which related to the purchaser-seller requirement.[132] Thus, even if Congress did purposefully refuse to amend section 10(b) in particular, it is not certain whether their refusal was based on a preference for the purchaser-seller rule.

The Court also attempted to derive congressional intent favorable to the *Birnbaum* doctrine from an examination of other provisions of the 1933 and 1934 Acts[133] limiting relief to purchasers and sellers.[134] The Court reasoned that it would be anomalous to expand the plaintiff class for a judicially implied cause of action beyond that for an express cause of action.[135] Although this is the Court's most persuasive argument,[136] it is nevertheless of doubtful validity. The

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[129] *See* SEC Security Exchange Act Release No. 3230 (May 12, 1942).

[130] The Supreme Court further failed to adequately examine the rationales that the lower courts have used to justify the purchaser-seller requirement. For example, it has been held that the *Birnbaum* doctrine is a standing requirement of constitutional stature. Mount Clemens Indus., Inc., v. Bell, 464 F.2d 339, 343 (9th Cir. 1972). *citing* Herpich v. Wallace, 430 F.2d 793, 805-06 (5th Cir. 1970). *Contra,* Eason v. G.M.A.C., 490 F.2d 654, 657 (7th Cir. 1973). Hence, under Article III of the U.S. Constitution, a plaintiff must show both injury in fact and that the interest he seeks to protect is within the zone of interests protected by the statute. *See* Association of Data Processing Serv. Orgs. v. Camp, 397 U.S. 150, 152, 153 (1970). It has been claimed that only purchasers and sellers can show injury of the type that Rule 10b-5 is meant to prevent. Herpich v. Wallace, *supra* at 805-06. The majority in *Blue Chip Stamps* appears to agree, as it held that only an actual purchaser or seller can suffer the requisite injury to maintain a private action. *See* 421 U.S. at 734-35. The purchaser-seller requirement, however, is not necessarily compelled by constitutional standing requirements. First, a nonpurchaser or nonseller can certainly suffer injury in fact. *See* Note, *Limiting the Plaintiff Class: Rule 10b-5 and the Federal Securities Code,* 72 MICH. L. REV. 1398, 1412-13 (1974) [hereinafter cited as *Plaintiff Class*]. For example, the plaintiffs in *Blue Chip Stamps* have possibly been injured by the fraud allegedly perpetrated upon them because they were precluded from accepting an advantageous offer which might have been profitable to them. In addition, nonpurchasers and nonsellers are arguably within the zone of interests protected by section 10(b) and Rule 10b-5. See text at notes 138-52 *infra.*

[131] *See generally* S.2544-2547, 85th Cong., 1st Sess. (1967), *cited in* 103 CONG. REC. 11631-41 (1957); *SEC Legislation, Hearing Before a Subcomm. of the Comm. on Banking & Currency,* 86th Cong., 1st Sess. (1959).

[132] See text at notes 90-93 *supra.*

[133] 15 U.S.C. §§ 77k, 77*l*, 78i, 78r (1970).

[134] 421 U.S. at 733.

[135] *Id.* at 736.

[136] The concurring opinion in *Blue Chip Stamps* also concentrated on this argument. *Id.* at 755-56 (Powell, J., concurring).

scope of section 10(b) is arguably broader than that of other sections, since it was drafted as a "catch all" provision.[137] Section 10(b) and Rule 10b-5 have always been interpreted broadly and flexibly to effectuate their common remedial purposes.[138] Therefore, the availability of relief should be correspondingly broad.

The protections of section 10(b) and Rule 10b-5 could reasonably be interpreted as extending to nonpurchasers and nonsellers. These provisions prohibit all fraudulent practices "*in connection with* the purchase or sale of any security."[139] Nothing in the text of these provisions expressly limits their protection to actual purchasers and sellers.[140] As one court has noted, there is "no justification in the legislative history of the Act or in the cases for reading this phrase as if it read merely 'in the purchase or sale' rather than 'in connection with the purchase or sale.' "[141] The phrase could just as well be construed to include offers.[142] When the SEC drafted Rule 10b-5 almost verbatim from section 17(a) of the 1933 Act, it could have closely followed the language of section 17(a) to prohibit fraud "upon the purchaser or seller."[143] Instead, the rule was broadly drafted to prohibit fraud "upon *any person* . . . ."[144] This expansive approach in promulgating the rule argues against a narrow approach in its construction.

Moreover, a careful reading of section 10(b) suggests that certain nonpurchasers and nonsellers are *expressly* entitled to protection. One theory of recovery in *Kardon v. National Gypsum Co.*,[145] the first decision to allow a private remedy under Rule 10b-5, was the statutory tort theory:[146] A person who violates a statute is liable in a private action for the harm done to another who is a member of the class protected by the statute.[147] The *Kardon* court found this right of redress "so fundamental and so deeply ingrained in the law" that it should not be denied unless the legislative intent to do so is very clear and plain.[148] Because certain nonpurchasers and nonsellers nonetheless

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[137] See text at note 63 *supra*. *See* 1 A. BROMBERG, SECURITIES LAW—FRAUD—SEC RULE 10b-5, § 2.5(6), at 45-46 (1974).

[138] Herpich v. Wallace, 430 F.2d 792, 802 (5th Cir. 1970).

[139] 15 U.S.C. § 78j(b) (1970) (emphasis added); 17 C.F.R. § 240.10b-5 (1975) (emphasis added).

[140] *See* James v. Gerber Prods. Co., 483 F.2d 944, 949 (6th Cir. 1973).

[141] Goodman v. H. Hentz & Co., 265 F. Supp. 440, 444 (N.D. Ill. 1967).

[142] This interpretation was, of course, rejected in *Birnbaum*, 193 F.2d at 463, as well as in *Blue Chip Stamps*, 421 U.S. at 733 n.5. The "in connection with" clause has usually been interpreted as requiring causation between the fraud and the purchase or sale. SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 860 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969); *see* 2 A. BROMBERG, *supra* note 137, § 7.6(2)(a), at 190.23-24.

[143] 15 U.S.C. § 77q(a)(3) (1970).

[144] 17 C.F.R. § 240.10b-5(c) (1975) (emphasis added).

[145] 69 F. Supp. 512 (E.D. Pa. 1946).

[146] *Id.* at 513-14.

[147] *Id.* The *Kardon* court based this theory on RESTATEMENT OF TORTS § 286 (1934).

[148] 69 F. Supp. at 514.

fall within the class protected by section 10(b)—investors—they should have a private right of action for the harm done to them by a violation of Rule 10b-5.[149] This argument would be based on the language of section 10(b) authorizing the SEC to promulgate rules "in the public interest or for the protection of investors."[150] The legislative intent to deny relief to these persons is not very plain and clear as the *Kardon* court would require. Rather, as the *Blue Chip Stamps* Court admits, the legislative history and intent is "not conclusive."[151] Nevertheless, the Court refused to grant standing to nonpurchasers and nonsellers.[152]

From a policy standpoint, the Court expressed the belief that the *Birnbaum* doctrine appropriately curtailed the danger of vexatious litigation under Rule 10b-5.[153] While there may exist a great danger of vexatiousness in Rule 10b-5 litigation, it is submitted that the Court has failed to adequately show that this danger of vexatiousness is different in degree or in a kind from that which accompanies litigation in general. The court correctly observed that it is difficult to dispose of a Rule 10b-5 suit before trial, other than by settlement.[154] This difficulty, however, is present in many types of litigation. Whenever there are complex factual issues which are hotly disputed, a settlement is often the only alternative to a long trial. For example, summary judgment is deemed inappropriate in complex antitrust litigation.[155] The Court also noted the related problem created by the dependence on oral testimony at trial to prove facts known only by the plaintiff.

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[149] Defining who is, in fact, an investor may be a difficult task. For example, the *Kardon* court defined investors broadly: "I cannot agree . . . that 'investors' is limited to persons who are about to invest in a security or that two men who have acquired ownership of the stock of a corporation are not investors merely because they own half of the total issue." *Id.* at 514. On the other hand, in Eason v. G.M.A.C., 490 F.2d 654 (7th Cir. 1973), the court defined investors narrowly, apparently including only persons who were principals or participants in the transactions. *Id.* at 659-60.

[150] The term "investors" was not defined in the 1934 Act. .

[151] 421 U.S. at 733.

[152] Instead, the Court relied on the other theory used by the *Kardon* court—the voidable contract theory. *Id.* at 735. The voidable contract theory is derived from 15 U.S.C. § 78cc(b) (1970), which provides that a contract made in violation of the 1934 Act is voidable. *Kardon,* 69 F. Supp. at 514. This section would be of little value unless there was a remedy for the injured party "to relieve himself of obligations under it or to escape its consequences." *Id.* at 514. The *Blue Chip Stamps* Court argued that this justification for a private cause of action under Rule 10b-5 would be absent in the case of a nonpurchaser or nonseller. 421 U.S. at 735. However, the statutory tort theory has been more widely used as a justification for the implied private cause of action under Rule 10b-5 than the voidable contract theory. 1 A. BROMBERG, *supra* note 137, § 2.4(1)(a), at 30.

[153] 421 U.S. at 737-49. See text at notes 97-116 *supra.*

[154] 421 U.S. at 742.

[155] Poller v. Columbia Broadcasting Sys. Inc., 368 U.S. 464, 473 (1962). There the Court said: "We believe that summary procedures should be used sparingly in complex antitrust litigation where motive and intent play leading roles, the proof is largely in the hands of the alleged conspirators, and hostile witnesses thicken the plot." *Id. See* C. WRIGHT, HANDBOOK OF THE LAW OF FEDERAL COURTS § 99, at 441-46 (1970).

However, the potential for perjury exists in litigation whenever one party has exclusive knowledge of the facts to which he testifies: for example, when state of mind or intention is a material issue. The better solution to this problem of oral testimony, in any event, would be to require some form of corroboration or independent evidence,[156] rather than to preclude the plaintiff from presenting any proof due to an arbitrary standing hurdle.

The Court was also concerned that the very pendency of a lawsuit may frustrate or delay normal business activity totally unrelated to the suit.[157] Any suit brought in good faith in which there exists a potential for a large award will likely interfere with the defendant's normal business.[158] Moreover, although the Federal Rules of Civil Procedure allow liberal discovery,[159] which might affect business activity, they provide ample protection against abuse of the discovery process.[160]

It is submitted that the *Birnbaum* doctrine does not meet or solve many of the problems of vexatious litigation that so concerned the Court in *Blue Chip Stamps*. The potential for vexatious suits under Rule 10b-5 arises, not from the possibility that a nonpurchaser or nonseller might sue, but rather from the very existence of a private cause of action. Many of the dangers and effects of vexatious litigation also exist when bona fide actions are maintained by actual pur-

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[156] Brief for SEC as Amicus Curiae at 26-27, Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975). The Court rejected this approach, asserting that the need for this sort of solution demonstrates the benefits of the *Birnbaum* doctrine. 421 U.S. at 744.

[157] 421 U.S. at 740.

[158] For example, any suit, whether bona fide or vexatious, might bring adverse publicity to a defendant corporation. *Cf.* Sargent, *The SEC and the Individual Investor: Restoring His Confidence in the Market*, 60 VA. L. REV. 533, 562-72 (1974). The Court in *Blue Chip Stamps* quotes Judge Friendly as saying that an "unduly expansive imposition of civil liability will lead to large judgments, payable in the last analysis by innocent investors, for the benefit of speculators and their lawyers . . . ." 421 U.S. at 739, *quoting* SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 867 (2d Cir. 1968) (concurring opinion), *cert. denied*, 394 U.S. 976 (1969). However, this statement was in reference to the dangers of extending a defendant's liability to acts of negligence, and not to the dangers of expanding the plaintiff class. In a case decided after *Blue Chip Stamps*, the Supreme Court held that a defendant was not liable for damages under Rule 10b-5 absent an intent to deceive, manipulate, or defraud. Ernst & Ernst v. Hochfelder, 44 U.S.L.W. 4451, 4454 (U.S. March 30, 1976). Courts should be more reluctant to hold a defendant liable for his acts than to permit a plaintiff from suing. Otherwise, even if a defendant is liable for a Rule 10b-5 violation which has caused injury to the plaintiff, the plaintiff would not be able to recover. In many suits, other than in Rule 10b-5 litigation, innocent people already pay the costs of the award: consumers through higher prices or subscribers of insurance through higher premiums. *See* Goldberg v. Kollsman Instrument Corp., 12 N.Y.2d 432, 442-43, 191 N.E.2d 81, 86, 240 N.Y.S.2d 592, 600 (1963) (dissenting opinion).

[159] *See* FED. R. CIV. P. 26-37.

[160] C. WRIGHT, *supra*, note 155, § 83, at 369. Abuse of discovery is not limited to Rule 10b-5 actions. There is great potential for such abuse in trade secret litigation, for example, *See id.* at 372.

chasers and sellers,[161] and the danger of vexatiousness would not be inordinately increased by abolishing the purchaser-seller requirement. A purchase or sale may be helpful in proving certain elements of a Rule 10b-5 action—for example, damages. But the absence of a purchase or sale would not necessarily preclude the plaintiff from proving all the elements of a valid claim. Indeed, an actual purchaser or seller may have an equally difficult time proving certain elements of a Rule 10b-5 action.[162] It would thus be more reasonable to require better forms of proof than to preclude the plaintiff from bringing his action in the first instance.[163] Courts regularly face the possibility of vexatious litigation and insufficient proof; they undoubtedly have the expertise to decide these issues on a more flexible and equitable basis than is done by the mechanical application of the *Birnbaum* doctrine.[164]

The only disadvantage of the *Birnbaum* doctrine which the Court discussed was that its arbitrariness prevents some plaintiffs with otherwise meritorious claims from successfully maintaining actions under Rule 10b-5.[165] However, the Court failed to fully appreciate the inconsistencies perpetrated in the name of the rule. Rule 10b-5 currently prohibits fraudulent practices which temporarily induce persons not to purchase or sell;[166] if, for example, a person discovers fraud which had earlier induced him not to sell, and upon discovering the fraud he does sell, he may bring a private action under Rule 10b-5.[167] However, the injury has actually been incurred through the induced retention of the shares, and not through the subsequent sale.[168]

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[161] *See* note 162 and accompanying text *infra*.

[162] For example, a purchaser or seller must still prove the existence of a fraudulent act proscribed by Rule 10b-5. Globus v. Law Research Serv., Inc., 287 F. Supp. 188, 197 (S.D.N.Y. 1968) *aff'd in part*, 418 F.2d 1276 (2d Cir. 1969), *cert. denied*, 397 U.S. 913 (1970). A purchaser or seller may still have to employ his own oral testimony to prove reliance, although it may be inferred from materiality. 2 A. BROMBERG, *supra* note 137, § 8.6(2), at 212. Reliance is the causal link between the fraud and the plaintiff's investment decision, *Plaintiff Class*, *supra* note 130, at 1418; the fact of a purchase or sale alone cannot assist the plaintiff in proving his reliance. Proof of reliance is thus inherently as difficult for the actual purchaser or seller as it is for the nonpurchaser or nonseller.

[163] See note 156 *supra*.

[164] *See* Comment, *supra* note 126, at 252.

[165] 421 U.S. at 738. The Court claimed that this disadvantage is to some extent lessened, since the plaintiff will often have a state law remedy. *Id.* at 738 n.9. This state remedy might not benefit such a plaintiff, however, because securities fraud is more difficult to prove under state law than under Rule 10b-5. *See* Hooper v. Mountain State Securities, Corp., 282 F.2d 195, 201 (5th Cir. 1960), *cert. denied*, 365 U.S. 814 (1961); 1 A. BROMBERG, *supra* note 137, § 2.7(1), at 55-56.

[166] Travis v. Anthes Imperial Ltd., 473 F.2d 515, 521-22 (8th Cir. 1973); Stockwell v. Reynolds & Co., 252 F. Supp. 215, 219 (S.D.N.Y. 1965).

[167] Stockwell v. Reynolds & Co., 252 F. Supp. 215, 219 (S.D.N.Y. 1965).

[168] Even the *Blue Chip Stamps* Court admitted that a nonpurchaser or nonseller may suffer injury as a result of a Rule 10b-5 violation. 421 U.S. at 738.

The plaintiff who has been induced not to purchase or sell may accordingly suffer injury just as easily as an actual purchaser or seller.[169] A plaintiff who has been induced not to purchase a security, as was the situation in *Blue Chip Stamps,* may not be financially able to purchase the securities at a later date. In addition, a plaintiff who has been induced not to sell his shares may not want to sell or may not be able to sell his holdings at a later date when he learns of the fraud. For example, the SEC might suspend trading of the security,[170] and it would thereafter be very difficult for the defrauded shareholder to dispose of his investment.

The situation of a plaintiff who has been induced not to sell his investment is somewhat analogous to that of a plaintiff who had been induced to actually purchase a particular security. In each instance, the plaintiff owns a security which he would not have owned had there been no fraud committed upon him. In the latter situation where the plaintiff has been induced to purchase, the actual purchase serves two functions. First, it of course serves to qualify the plaintiff under the *Birnbaum* doctrine. But this purpose of requiring a shareholder to purchase or sell would be unnecessary without the purchaser-seller requirement. Likewise, a nonpurchaser or nonseller would not need to complete a transaction in the absence of the *Birnbaum* doctrine. Second, the purchase assists in measuring damages. The shareholder who has been induced not to sell, however, can often determine the price at which he would have sold had there been no fraud.[171] The fraudulently induced purchaser is not required to subsequently sell his shares before he can maintain a private action under Rule 10b-5.[172] Thus, requiring the nonseller plaintiff to actually sell would appear to be a needless formality in the absence of the *Birnbaum* rule.[173]

This limitation of the *Birnbaum* doctrine—that it prevents persons who have been induced not to purchase or sell from bringing a private action under Rule 10b-5—undermines several of the reasons for implying private actions for damages under Rule 10b-5. One of these reasons is to encourage assistance in the enforcement of the securities laws.[174] Where the defendant's fraud induces people not to purchase or sell, however, the only persons who would have the incentive to sue—the nonpurchasers and nonsellers who were actually defrauded—are barred by the *Birnbaum* doctrine. Thus, under *Birnbaum,* there is no private party to aid in the SEC's enforcement of

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[169] *Plaintiff Class, supra* note 130, at 1412.

[170] *See* 15 U.S.C. § 78s(a)(2) (1970).

[171] See text at note 211 *infra.*

[172] 3 A. BROMBERG, *supra* note 137, § 9.1, at 226.

[173] *Cf.* Vine v. Beneficial Fin. Corp., 374 F.2d 627, 634 (2d Cir.), *cert. denied,* 389 U.S. 970 (1967).

[174] Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228, 241 n.18 (1974); *see Blue Chip Stamps,* 421 U.S. at 730, *citing* J.I. Case Co. v. Borak, 377 U.S. 426, 432 (1964).

the securities laws where the fraud prevents the contemplated transaction.[175] Private damage actions also disgorge illegal profits realized by the defendant as a result of his fraud.[176] Disgorging the violator's illegal profits acts as a deterrent against further fraud, and in this manner, regardless of whether a securities transaction occurred, a private action also assists the SEC in deterring future violations.

Another reason for allowing private damage actions is to compensate the victim of the fraud.[177] Injunctive remedies and criminal penalties may halt and punish those who commit fraudulent practices, but they do nothing to restore the loss of the defrauded victim. A nonpurchaser or nonseller is just as vulnerable to injury as an actual purchaser or seller.[178] Only if investors know that they can be compensated for injuries resulting from fraud will there be confidence in the securities markets and will the compensatory purpose of the private action be effectuated.[179] As the Court in *Blue Chip Stamps* recognized,[180] the *Birnbaum* doctrine arbitrarily precludes some of these injured persons from any compensation under federal law.

In summary, the *Birnbaum* doctrine is mandated neither by legislative history and intent nor by policy considerations. The purchaser-seller requirement does not solve the problem of vexatious litigation. Most importantly, the purposes of the securities laws are hindered by retention of the rule.

III. AN ALTERNATIVE TO *BIRNBAUM*

Any alternative to the *Birnbaum* doctrine should have the capability of extending section 10(b) protection to injured persons without imposing arbitrary and irrelevant restrictions on the ability to recover under Rule 10b-5. Abolition of the *Birnbaum* doctrine,[181] however,

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[175] Private injunctive relief may be sought by nonpurchasers and nonsellers. Mutual Shares Corp. v. Genesco, Inc., 384 F.2d 540, 546-47 (2d Cir. 1967). Such relief, however, is ineffectual where the fraud has already been completed, as in *Blue Chip Stamps*.

[176] Janigan v. Taylor, 344 F.2d 781, 786 (1st Cir.), *cert. denied*, 382 U.S. 879 (1965).

[177] Note, 16 B.C. IND. & COM. L. REV. 503, 512 (1975).

[178] *Plaintiff Class, supra* note 130, at 1412.

[179] Baird v. Franklin, 141 F.2d 238, 244-45 (2d Cir.) (dissenting opinion), *cert. denied*, 323 U.S. 737 (1944).

[180] 421 U.S. at 738.

[181] After the *Blue Chip Stamps* decision, only Congress could eliminate the *Birnbaum* doctrine. Prior to *Blue Chip Stamps*, it was uncertain whether the SEC had the authority to abolish the purchaser-seller rule. *See generally*, 3 A. BROMBERG, *supra* note 137, § 12.9, at 286 (SEC has limited authority to change Rule 10b-5). On the one hand, it has been argued that the *Birnbaum* court based the purchaser-seller requirement solely on Rule 10b-5, Comment, 6 LOYOLA U. CHI. L.J. 230, 239 (1975), and therefore the SEC could abolish the rule by amending Rule 10b-5. *See* 3 L. LOSS, SECURITIES REGULATION 1469 n.87 (1961). On the other hand, if the *Birnbaum* doctrine is based on § 10(b), Herpich v. Wallace, 430 F.2d 792, 806 (5th Cir. 1970), then the S.E.C. would have no authority to change the purchaser-seller requirement. After *Blue Chip Stamps*,

would not necessarily require that any and all persons be allowed to bring a Rule 10b-5 action. Section 10(b) was not intended to "establish a scheme of investors' insurance."[182] Instead, Congress sought to purify the investment decision-making process, rather than protect the individual investor.[183] Rule 10b-5 effectuated this purpose of promoting free and open securities markets and protecting the investing public from inequities in trading.[184] Thus, standing should be granted to any plaintiff who has been defrauded by a Rule 10b-5 violation that affects the investment decision making process rather than merely an actual investment. Under this standard, a plaintiff would be required to allege that he has made an actual investment decision—either to consummate a transaction or to refrain from completing a purchase or sale.[185] An actual purchaser or seller has made an investment decision by the fact of his purchase or sale.[186] However, a decision not to purchase or sell can be equally as important.[187] By committing himself to either type of decision, the investor may suffer injury. Hence, a plaintiff should not be denied standing solely because the fraud induced him to refrain from purchasing or selling securities.

A plaintiff should be required to prove his investment decision by evidence which is either independent of or at least corroborative of his oral testimony. A purchaser or seller could meet this proof requirement by introducing evidence of his purchase or sale. In such cases, there is an outward manifestation of action on his part. A nonpurchaser or nonseller, on the other hand, usually has not manifested any visible act. A person who has made an actual decision not to purchase or sell is often outwardly and objectively indistinguishable from a person who merely has failed to make any type of decision. Moreover, the fact of an investment decision is often solely within the plaintiff's knowledge and cannot be disproved. Thus, a plaintiff who has not made a decision would easily be able to claim that one had in

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the SEC has no authority to eliminate the purchaser-seller rule by any method, because the majority justifies the *Birnbaum* doctrine in light of congressional intent and policy considerations, which supersede the Commission's authority.

[182] List v. Fashion Park, Inc., 340 F.2d 457, 463 (2d Cir.), *cert. denied*, 382 U.S. 811 (1965).

[183] Note, 53 N.C.L. REV. 150, 158 (1974).

[184] SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 858 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969).

[185] In addition, the plaintiff must allege, and later prove, that his investment decision was caused by the defendant's fraud. List v. Fashion Park, Inc., 340 F.2d 457, 462 (2d Cir.), *cert. denied*, 382 U.S. 811 (1965); Note, *Limiting the Plaintiff Class: Rule 10b-5 and the Federal Securities Code*, 72 MICH. L. REV. 1398, 1418 (1974). For a discussion of proof of reliance, see note 156 *supra*. The fraud must be material; that is, of such a nature that "a reasonable man would attach importance [to it] in determining his course of action." SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 849 (2d Cir. 1968). Therefore, a material fraud is one which necessarily will affect the decision making process.

[186] *But cf.* Vine v. Beneficial Fin. Co., 374 F.2d 627, 634-35 (2d Cir.), *cert denied*, 389 U.S. 970 (1967).

[187] *Plaintiff Class*, *supra* note 185, at 1425.

fact been made. Objective evidence of an investment decision, therefore, would separate the bona fide plaintiff who in fact made a decision, from the opportunistic plaintiff who made no decision but claims later that he was defrauded.

Several forms of evidence would be acceptable. First, documentary evidence might be offered to show an investment decision.[188] For example, the plaintiff may have mailed a letter in which he rejected an offer made to him.[189] Second, indirect or circumstantial proof in the form of an inference could be allowed: an investment decision could be inferred from the plaintiff's failure to accept an offer. If an offer has been presented to the plaintiff and he has knowledge of it, the fact of his failure to accept the offer implies that he made a decision not to accept.[190] This would still be objective evidence, because it could be offered independent of the plaintiff's oral testimony. This would be an acceptable inference in a closed transaction situation, where the parties are dealing face-to-face, because the plaintiff would then certainly have knowledge of the offer.[191] In the open market situation, however, where offers are not made to particular individuals, and where knowledge of the offer is uncertain, this inference

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[188] *See* Neuman v. Electronic Specialty Co., [1969-1970 Transfer Binder] CCH FED. SEC. L. REP. ¶92,951, at 98,705-06 (N.D. Ill. 1969) (attempted acceptance of an offer by telegram).

[189] This documentary evidence, like any other evidence, may always be impeached. For example, it might be shown that the plaintiff never had any intention of purchasing securities, by showing that he had sent many such letters indicating his intention not to purchase, in anticipation of hitting at least one offering subsequently revealed to be tainted by fraud.

[190] Note that this conclusion does not require a further conclusion that an act of the offeror caused the plaintiff to reject the offer. Causation is a separate issue from the question of whether an investment decision of the "no purchase" or "no sale" variety was made. Treating causation separately allows for the fact that in most instances, an offeror will not simultaneously make an offer and then engage in fraud to induce the offeree not to accept. It would be pointless for an offeror to voluntarily make an offer which he did not want the offeree to accept. *Blue Chip Stamps*, in which the offeror induced the offeree not to accept, is an unusual case in this respect. But it must be remembered that the offer in *Blue Chip Stamps* was not voluntarily made; rather, it was mandated pursuant to an antitrust decree. However, a third person might not want a voluntary transaction to be completed, and might induce the offeree not to accept. *See* Neuman v. Electronic Specialty Co., [1969-1970 Transfer Binder] CCH FED. SEC. L. REP. ¶ 92,951, at 98, 701 (N.D. Ill. 1969).

[191] A plaintiff's failure to accept an offer should be questioned in any instance where the offer is not made directly to the plaintiff. The plaintiff should be required to prove that he had knowledge of the offer.

A situation where this presumption may have been valuable at one time is the tender offer case. Tender offers have become increasingly common since the early 1960's. H. REP. No. 1711, 2 U.S. Code Cong. and Ad. News 2811-12, 90th Cong., 2d Sess. (1968). Originally, a nonpurchaser or nonseller defrauded in a tender offer situation had no recourse under Rule 10b-5. Iroquois Indus., Inc. v. Syracuse China Corp., 417 F.2d 963, 965 (2d Cir. 1969), *cert. denied*, 399 U.S. 909 (1970). Section 14(e) of the 1934 Act, 15 U.S.C. § 78n(e) (1970), added to the 1934 Act in 1968, now provides a private right of action in favor of such nonpurchasers and nonsellers. Smallwood v. Pearl Brewing Co., 489 F.2d 579, 596-97 & n.20 (5th Cir.), *cert. denied*, 419 U.S. 873 (1974).

would be less warranted. In this situation, greater proof would be required.[192]

In addition to offering proof of an investment decision, the plaintiff must also show that this decision was caused by the alleged violation of Rule 10b-5.[193] Where there has been a material misrepresentation, it may have the effect, if not the purpose, of inducing a particular investment decision—either to purchase or sell, or to refrain from doing either. If the plaintiff has not made any investment decision, he should be denied standing. However, if the plaintiff has made a decision, he must still prove that it was caused by the defendant's fraud; he must show reliance.[194] As reliance is a subjective test, proof is usually by the plaintiff's oral testimony. Reliance may also be inferred from materiality.[195] In any event, a nonpurchaser or nonseller who has in fact made an investment decision does not necessarily have a more difficult time in proving reliance than an actual purchaser or seller. A purchase or sale is not proof of reliance; reliance is a test of causation, and the purchase or sale could have been caused by factors other than fraud.[196]

In determining causation, a nondisclosure situation presents difficulties not encountered in a misrepresentation case. Unlike the effect of a misrepresentation, the effect of a nondisclosure may be to induce the plaintiff not to make any investment decision, at least with respect to the undisclosed information. For example, if a corporation does not disclose adverse information, a shareholder might not sell his interest in that corporation, though he would have sold if the information had been disclosed. The nondisclosure does not induce a shareholder to make a decision not to sell; rather, it induces him to make no decision at all. Therefore, the requirement of an actual investment decision in a nondisclosure case is analytically unwarranted. In a nondisclosure case, where no investment decision has been made, the element of active reliance becomes meaningless.[197] The proper

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[192] Some forms of proof would not be acceptable, because they would be either not relevant or too speculative. The Court is correct in suggesting that receipt of a prospectus or ownership of stock are not acceptable. These do not show that an investment decision has been made. 421 U.S. at 747.

[193] *See* List v. Fashion Park, Inc., 340 F.2d 457, 462-63 (2d Cir.), *cert. denied*, 382 U.S. 811 (1965).

[194] *Plaintiff Class, supra* note 185, at 1418. Reliance limits invocation of Rule 10b-5 only to those plaintiffs who were in fact defrauded. Financial Programs, Inc. v. Falcon Financial Serv., Inc., 371 F. Supp. 770, 775 (D. Ore. 1974). Although a plaintiff may have suffered injury resulting from a Rule 10b-5 violation, he cannot recover unless he has been defrauded. List v. Fashion Park, Inc., 340 F.2d 457, 462-63 (2d Cir. 1965).

[195] 2 A. BROMBERG, SECURITIES LAW—FRAUD—SEC RULE 10b-5, § 8.6(2) at 212 (1974).

[196] *See* List v. Fashion Park, Inc., 340 F.2d 457 (2d Cir.), *cert. denied*, 382 U.S. 811 (1965) where it was determined that the plaintiff would have sold his stock, regardless of any fraud. *Id.* at 464.

[197] Painter, *Inside Information: Growing Pains for the Development of Federal Corporation Law Under Rule 10b-5*, 65 COLUM. L. REV. 1361, 1370 (1965).

test of causation should be whether the plaintiff would have acted differently had there been full disclosure.[198]

This test, however, is not without problems, for it is often difficult to determine how a plaintiff would have acted had there been full disclosure. In most instances, a plaintiff would not be able to offer direct proof that he would have acted differently. However, since a plaintiff could easily allege that he would have acted differently, the amount of Rule 10b-5 litigation might dramatically increase. This increase, though not harmful in itself, would be injurious if much of it were comprised of unmeritorious claims. Such a situation is better managed, however, by the requirement of proof than through the prerequisite of standing. In Rule 10b-5 litigation, even an actual purchaser or seller may have difficulty in showing that he would have acted differently had certain disclosures been made.[199] There is thus little reason to deny standing to one potentially affected by the same nondisclosure merely because he has not completed a transaction.

Since direct proof of causation where nondisclosure is involved is almost impossible, it becomes necessary to employ inferential proof. In *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*,[200] the court held that causation in fact is to be inferred from the materiality of the defendant's violation of Rule 10b-5, because the plaintiffs might have considered the undisclosed information important in making their decision to purchase stock.[201] If causation is to be established from the fact of materiality, nonpurchasers and nonsellers would benefit from such an inference equally with actual purchasers and sellers, since both groups would by definition attach importance to the *material* nondisclosure.[202] However, a causation test based upon materiality would bear little relation to whether the plaintiff would have actually acted differently. An inference based on materiality would allow standing to everyone because, again by definition, all reasonable men would attach importance to a material fraud.

A causation test that would be more relevant to the issue of whether the plaintiff would have acted differently had there been full disclosure is one that would examine the nature of the plaintiff. Some plaintiffs are more likely than others to have acted differently, since their activities in the marketplace and their motives for investing are different.[203] Actual purchasers, sellers, and those who made a documented investment decision are the plaintiffs most likely to have acted differently. Since these persons were actively involved and

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[198] Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228, 239 (2d Cir. 1974), *citing* List v. Fashion Park, Inc., 340 F.2d 457, 463 (2d Cir. 1965).

[199] *See* List v. Fashion Park, Inc., 340 F.2d 457, 464 (2d Cir.), *cert. denied*, 382 U.S. 811 (1965) (plaintiff would have still sold his stock even if there was full disclosure).

[200] 495 F.2d 228 (2d Cir. 1974).

[201] *Id.* at 240.

[202] See note 177 *supra*.

[203] Note, *The Measure of Damages in Rule 10b-5 Cases Involving Actively Traded Securities*, 26 STAN. L. REV. 371, 379 (1974) [hereinafter cited as *Damages*].

committed themselves on the basis of incomplete information, it is doubtful that they would have continued to act to their detriment had they knowledge of all material information.

The next category of plaintiffs are shareholders defrauded by a nondisclosure who have not made any investment decision; since they have been passive, it is more difficult to determine whether they would have acted differently. There are many different types of shareholders. A speculator, trader, or institutional holder is very likely to have acted differently since he is probably very informed with respect to his investment. A long term shareholder, on the other hand, might have held on to his holdings regardless of the existence of adverse information.[204] There is, of course, no sharp dividing line separating various types of shareholders. The courts would likely have to sift through the facts of each case to determine if the plaintiff had met his burden of proving causation in fact. The problem of proving causation in fact, however, exists in many other types of litigation.[205] It is submitted that the difficulties of determining causation in fact are outweighed by the disadvantages of arbitrarily precluding defrauded nonpurchasers and nonsellers from suing under Rule 10b-5.[206]

Even after a plaintiff has shown that his investment decision making process was affected and that he was injured, he must still prove his damages. Proof of damages is, of course, not a requisite of standing. Nonetheless, it deserves brief consideration here because of the unique problems of the new class of potential plaintiffs who would have standing under the investment decision rule. To prove his damages, the plaintiff must establish the terms of the transaction, namely, the number of shares and the price of each. An actual purchaser or seller can readily prove what these terms were. However, a nonpurchaser or nonseller can only show what these terms might have been but for the defendant's fraud, since the transaction was never completed. In general, a nonpurchaser or nonseller will have greater difficulty in proving the terms of the aborted transaction. Indeed, in the nondisclosure situation no transaction may ever have been contemplated, thus rendering even more difficult the task of evaluating damages. Yet, a plaintiff should not be denied relief solely because the amount of damages is difficult to determine.[207] Objective evidence should once again be required; inferences and presumptions based on the objective evidence may be an appropriate compromise.

In the case of a closed transaction where there exists an offer involving a particular number of shares, a presumption that the plain-

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[204] *Id.* Nonshareholders who have not made an investment decision do not have a sufficient nexus to the particular security involved and should not be granted standing, even though it is possible that such a person would have acted differently. Otherwise, the nonshareholder who has not made an investment decision could always sue with respect to fraud affecting any security.

[205] *See* W. PROSSER, HANDBOOK OF THE LAW OF TORTS, § 41 (4th ed. 1971).

[206] See text at notes 174-80 *supra.*

[207] Comment, 6 LOYOLA U. CHI. L.J. 230, 252 (1975); *Damages, supra* note 203, at 385.

tiff would have accepted the offer in full should exist. Similarly, it should be presumed that a shareholder would have sold all his shares in the open market were it not for the defendant's fraud. These presumptions are justified, because it is rational for a person to maximize his profits by accepting a profitable and advantageous offer in full, or by selling all his shares. These presumptions might not be accurate in every case.[208] However, the impact of these presumptions would be limited by the fact that they could be rebutted.[209]

A nonpurchaser or nonseller may also have trouble determining the price at which he would have purchased or sold a security. This problem is minimized in a closed dealing where the price is fixed. In an open market situation, however, where the price of a security is continually fluctuating, a nonpurchaser or nonseller will have greater difficulty in proving the price at which he would have completed the transaction.[210] However, at least in a misrepresentation case, the plaintiff has already established an investment decision. From this decision, the date of the aborted transaction can often be determined and a price can then be estimated.[211] Since a plaintiff defrauded by a nondisclosure may not have made an investment decision, he may not be able to offer sufficient proof of his damages.

This proposed alternative to the *Birnbaum* doctrine satisfies the concerns of the *Blue Chip Stamps* Court. First, it is consistent with the legislative scheme of the securities laws, because it protects those persons who ought to be protected by Rule 10b-5.[212] By requiring objective evidence and sensible standards of proof,[213] this alternative meets most of the Court's concerns about vexatious litigation. Although

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[208] Even in criminal law, presumptions are allowed, although they are not entirely accurate. *See* Turner v. United States, 396 U.S. 395, 405-18 (1970).

[209] For example, it might be shown that the plaintiff customarily sold only part of his holdings at a particular time, or that the particular situation did not warrant a complete sell out. The presumptions would certainly better effectuate the purpose of allowing private actions under Rule 10b-5 than the exclusion of all defrauded nonpurchasers and nonsellers.

[210] Proving damages in the open market is difficult even for the actual purchaser or seller. *See generally Damages, supra* note 203, at 374-76.

[211] Neuman v. Electronic Specialty Co., [1969-1970 Transfer Binder] CCH FED. SEC. L. REP. ¶92,591, at 98,703-04 (N.D. Ill. 1969). Perfect accuracy in measuring damages in open market transactions is never attainable. *Damages, supra* note 203, at 385 n.72. Relief should be denied if the amount of damages is unreasonably speculative. For example, where insiders are violating Rule 10b-5 by trading in a security without disclosing inside information, the price of the security may fluctuate greatly in a very short time. *See, e.g., Shapiro*, 495 F.2d at 233 n.8 (selling by tippees allegedly caused Douglas Aircraft stock to decrease by 18 points in 3 days). The price at which a nonpurchaser or nonseller would have consummated a transaction in this situation is totally unpredictable. Indeed, nonpurchasing and nonselling plaintiffs will allege that they would have completed a transaction if there had been full disclosure. However, if all these plaintiffs had attempted to sell or purchase, their transactions, in combination with those of the insiders, would have caused even sharper price fluctuations. Under such circumstances, damages would be even more unpredictable.

[212] See text at notes 199-203 *supra*.

[213] *Blue Chip Stamps*, 421 U.S. at 711 (Blackmun, J., dissenting).

some vexatious claims could exist under the proposed alternative, this vexatiousness would be of the sort that even the purchaser-seller requirement would not be able to eradicate, and it may best be solved by methods less drastic than a denial of standing.[214]

In addition, allowing nonpurchasers and nonsellers to sue under Rule 10b-5 would best effectuate the purposes of allowing private litigation under the securities laws. A person who has been injured in connection with a securities transaction would be compensated for his loss. Elimination of the restrictive *Birnbaum* doctrine would thus help to increase confidence in the securities markets. Moreover, immunity from private actions would no longer automatically exist where the defendant's fraud induced people to refrain from purchasing or selling securities. Finally, profits would be disgorged from wrongdoers.

It is likely, however, that most of those who would gain standing as a result of the *Birnbaum* doctrine's elimination will have been involved in closed transactions or direct offer situations where there was "some semblance of privity"[215] between the parties to the transaction.[216] Very few nonpurchasers and nonsellers who were defrauded with respect to open market transactions are likely to be able to offer sufficient proof in order to successfully litigate a claim under Rule 10b-5. On the one hand, this will as a practical matter exclude

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[214] For example, section 10(b) should be amended to allow the court to require the plaintiff to post security or to assess costs against a litigant. Since private actions under section 10(b) are a judicial invention, costs are not normally awarded. "In exceptional circumstances, however, where the behavior of a litigant has reflected a willful and persistent 'defiance of the law', a court of equity has the power to charge an adverse party with plaintiff's counsel fees as well as court costs." Kahan v. Rosenstiel, 424 F.2d 161, 167 (3d Cir.), *cert. denied*, 398 U.S. 950 (1970). Each of the express private remedy provisions in the 1933 and 1934 Acts, 15 U.S.C. §§ 77k(e), 77*l*, 78i(e), 78r(a), contains a provision similar to that in 15 U.S.C. § 77k(e):

> In any suit under this or any other section of this subchapter the court may, in its discretion, require an undertaking for the payment of the costs of such suit, including reasonable attorney's fees, and if judgment shall be rendered against a party litigant, upon the motion of the other party litigant, such costs may be assessed in favor of such party litigant (whether or not such undertaking has been required) if the court believes the suit or the defense to have been without merit, in an amount sufficient to reimburse him for the reasonable expenses incurred by him, in connection with such suit, such costs to be taxed in the manner usually provided for taxing of costs in the court in which the suit was heard.

The purpose of these provisions was to alleviate the fear of strike and vexatious suits. *See* 78 CONG. REC. 8669 (1934) (remarks of Senator Fletcher). Apparently, "[t]his section provides 'for more unrestricted recovery than would be possible at common law . . . .'" Acker v. Schulte, 74 F. Supp. 683, 688 (S.D.N.Y. 1947), *citing* Baird v. Franklin, 141 F.2d 238, 245 (2d Cir.) (dissenting opinion). In general, costs are awarded under these express remedy provisions when a claim is brought in bad faith or without merit. Acker v. Schulte, *supra* at 684.

[215] Joseph v. Farnsworth Radio & Television Corp., 99 F. Supp. 701, 706 (S.D.N.Y. 1951), *aff'd per curiam*, 198 F.2d 883 (2d Cir. 1952).

[216] The *Blue Chip Stamps* Court discussed the history of the tort of misrepresentation and deceit, noting that this tort has developed in connection with personal transactions, in sharp contrast to transactions being conducted over the nation's securities markets today. 421 U.S. at 744-45.

many claims with extremely large damages, in which the plaintiff's losses might greatly exceed the defendant's illegal gains.[217] Thus, the suggested alternative to *Birnbaum* would not automatically overburden the defendant with excessive judgments. On the other hand, however, the protective purposes of the 1934 Act will not be carried out to the fullest extent possible if nonpurchasers and nonsellers are not protected to some degree in open market dealings.

ROBERT E. FOX

Antitrust Law—Application of the *Data Processing* Standing Test in Treble Damage Actions—*Malamud v. Sinclair Oil Corp.*[1]—In 1968, Malco Petroleum, Inc., three real estate investment companies, and Jack and Anne Malamud, the officers, directors, and sole shareholders of the four corporate plaintiffs, instituted an action against Sinclair Oil Corp. in federal district court alleging violations of section 1 of the Sherman Act[2] and section 3 of the Clayton Act[3] arising out of a series of transactions between the parties.[4] Sinclair and Malco had entered into a distribution agreement in 1965.[5] Under the terms of the agreement, Sinclair promised to supply Malco with petroleum products for resale to retail customers. The parties to the agreement also arrived at an oral understanding whereby Sinclair was to supply financial assistance to the three investment companies to aid them in acquiring and developing new service stations.[6] Subsequent to the agreement, Sinclair refused financial assistance in five possible acquisitions proposed by Jack Malamud acting as an officer of the investment companies.[7] After Sinclair had refused to assist in all five of the proposed ventures, Jack Malamud negotiated a new contract with Texaco, Inc. and unsuccessfully sought an early termination of the contract between Malco and Sinclair.[8] Subsequently, the contract ran its course and, upon termination, Malco executed a new distribution agreement with Texaco, Inc. covering those service stations which had previously been supplied by Sinclair.[9]

The gist of plaintiffs' antitrust claim was that the agreement between Sinclair and Malco required Malco to secure its supply of prod-

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[217] *See* Note, 16 B.C. IND. & COM. L. REV. 503, 512-13 (1975).

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[1] 521 F.2d 1142 (6th Cir. 1975).
[2] 15 U.S.C. § 1 (1970).
[3] 15 U.S.C. § 14 (1970).
[4] *Malamud*, 521 F.2d at 1144-45.
[5] *Id.* at 1144.
[6] *Id.*
[7] *Id.*
[8] *Id.*
[9] *Id.*